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No. 199

In the Supreme Court of the United States

OCTOBER TERM, 1954

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GLENSHAW GLASS COMPANY

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM GOLDMAN THEATRES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

SIMON E. SOBELOFF,
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Department of Justice, Washington 25, D. C.

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In the course of oral argument in these cases on February 28, 1955, the Court asked the Solicitor General to submit a memorandum reviewing the administrative practice as to the taxability of payments of punitive damages and certain other types of gains which it was suggested might be analogous. This memorandum is submitted pursuant to that request.

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I

ADMINISTRATIVE PRACTICE

The Commissioner of Internal Revenue, after a review of the pertinent records on file in his office, informs us that, so far as research discloses, the policy position and administrative practice of the Internal Revenue Service with respect to the items in question is and has been as follows:

1. *Damages to property.*

(a) *Actual damages.*

The Commissioner has consistently held recoveries on account of actual damages to business or property to be taxable in so far as they represent damages for lost profits or damages to property which has no tax basis. The files reveal instances in 1922 (settlement of antitrust suit for damages); 1925 (recovery by corporation against directors for improper diversion of funds); 1927 (damages for unfair competition); 1930 (recovery by landowner for destruction of wild fur-bearing animals); 1930 (recovery for injury to water rights of taxpayer). See further *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; Govt. Main Brief, p. 38.

(b) *Punitive damages.*

The Commissioner has consistently held punitive damages recovered in actions involving injury to business to be taxable as income. Thus, in 1919, the Commissioner ruled that damages recovered by an attorney in an action for libel of his professional reputation were taxable as

income. The damages included both general and punitive damages. A summary of this ruling is published in 1 Cum. Bull. 65 (1919).

A search of the files reveals no further rulings as to the taxability of punitive damages arising out of injury to business until the *Highland Farms* case. As is apparent from the decision in *Highland Farms Corp.* v. *Commissioner,* 42 BTA 1314, the Commissioner there asserted tax on a payment of $10,000 received by the taxpayer as punitive damages. This item was one of a number of items contested in the suit, and itself accounted for less than five percent of the total adjustments to gross income in issue. The Board decided against the Government on all issues. The Commissioner acquiesced in this decision in part (see 1941–1 Cum. Bull. 16). As to the relatively minor item consisting of punitive damages, however, and certain other issues, the Commissioner published his non-acquiescence therein, thus announcing that he was adhering to his position that punitive damages constitute taxable income and informing all concerned that the contrary holding in the *Highland Farms* case was not accepted by him.[1]

[1] The practice by the Commissioner of indicating acquiescense or nonacquiescence in decisions of the Tax Court dates from the inception of the court, originally known as the Board of Tax Appeals. In the first Cumulative Bulletin published after the organization of the Board, the Commissioner announced that "No decision of the Board of Tax Appeals disallowing a tax determined by the Commissioner

The deficiencies asserted in the instant cases as well as other recent cases [2] indicate that the Commissioner has since consistently adhered to this position. The statements of policy contained in the cited rulings are, of course, binding on the officers and employees of the Internal Revenue Service who administer the income tax laws.

2. *Damages to persons.*

The Commissioner has held that damages to persons are not taxable as income. Where, however, a part of the recovery is earmarked as for lost earnings, the Commissioner has held such recovery to be taxable. The Commissioner has

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to be due will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases unless and until the Commissioner definitely announces his acquiescence in such decision or, if the matter is submitted to the courts, until after final adjudication." III–2 Cum. Bull. IV (1924). The first instance of non-acquiescence occurred in the same year. *Appeal of Joseph Garneau Co.*, III–2 Cum Bull. 304 (1924). In that decision the Commissioner announced that "Pending final adjudication of the matter by the courts, officers and employees of the Bureau of Internal Revenue will disregard this decision of the Board of Tax Appeals and will proceed in the case of assessments made prior to June 2, 1924, in accordance with existing regulations." *Ibid.* Similar announcements of policy have appeared regularly in subsequent issues of the Bulletin. E. g., 1941–1 Cum. Bull. IV; 1948–1 Cum. Bull. IV; 1954–1 Cum. Bull. 3. This practice has been recognized by this Court. *Douglas* v. *Commissioner*, 322 U. S. 275, 286, n. 5; *Helvering* v. *Pfeiffer*, 302 U. S. 247, 249.

[2] *E. g.*, *Obear-Nester Glass Co.* v. *Commissioner*, No. 478, O. T. 1954, pending on writ of certiorari; *Telefilm, Inc.* v. *Commissioner*, 21 T. C. 688.

not specifically ruled on the question whether a recovery of punitive damages in connection with claims for damages to personal rights is taxable as income; the Board of Tax Appeals has expressly reserved this question.

These conclusions are based on the following:

In 1918 the Attorney General ruled that the proceeds of an accident insurance policy were not subject to tax, "the conclusion being based upon the reasoning that the human body is a kind of capital and that the proceeds of the insurance policy really represented a conversion of the capital lost through the injury".[3] See 2 Cum. Bull. 71, 72; T. D. 2747, Treasury Decisions, Internal Revenue, Vol. 20 (Jan.–Dec. 1918), p. 457.

In 1922 the Commissioner issued a general ruling as to the taxability of damages for injury to personal or family rights including damages for alienation of affections,[4] damages for slander or libel of personal character, and money received by a parent in consideration for the surrender of

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[3] The 1939 Code contains a provision exempting compensation for personal injuries or sickness, received under insurance policies or as damages, from tax. Sec. 22 (b) (5). Amounts received under life insurance contracts paid by reason of the death of the insured are also exempt. Sec. 22 (b) (1).

[4] In *McDonald* v. *Commissioner*, 9 B. T. A. 1340, the Board of Tax Appeals held damages on account of breach of promise to marry to be not includible in taxable income. The Commissioner acquiesced in this decision (VII–2 Cum. Bull. 26 (1928)), and thereafter published a ruling consistent with the decision and revoked prior rulings to the contrary.

his right to the custody of his minor child. In that ruling the Commissioner ruled that such receipts are not taxable, reasoning as follows (I–1 Cum. Bull. 92, 93 (1922)):

> * * * In either case the right invaded is a personal right and is in no way transferable. While a jury endeavors roughly to compute the amount of damage inflicted, in the very nature of things there can be no correct estimate of the money value of the invaded rights. The rights on the one hand and the money on the other are incomparable things which can not be placed on opposite sides of an equation. If an individual is possessed of a personal right that is not assignable and not susceptible of any appraisal in relation to market values, and thereafter receives either damages or payment in compromise for an invasion of that right, it can not be held that he thereby derives any gain or profit.

This ruling expressly stated that slander and libel affecting business reputation or property rights were not considered in the ruling.

In 1927 the Board of Tax Appeals held that damages received for injury to personal reputation and health caused by defamatory statements are not income. "Such compensation as general damages adds nothing to the individual, for the very concept which sanctions it prohibits that it shall include a profit. It is an attempt to make the plaintiff whole as before the injury." *C. A.*

Hawkins v. *Commissioner,* 6 B. T. A. 1023, 1025. The Board, however, expressly reserved the question as to the taxability of punitive damages, commenting (*ibid.,* p. 1024):

> * * * it is conceivable that since the income tax is primarily an application of the idea of measuring taxes by financial ability to pay, as indicated by the net accretions to one's economic wealth during the year, there may be cases in which taxable income will be judicially found although outside the precise scope of the description already given.

The Commissioner's files further indicate that in a 1946 case involving a settlement agreement under which the taxpayer received an award as damages for "erroneous imprisonment," a portion of which was designated as damages for loss of earnings, the Commissioner held that that portion of the award which covered loss of earnings was taxable as income.

3. *Damages for malicious interference with contract rights.*

The Commissioner's search does not reveal any cases involving damages for malicious interference with contract rights. As a matter of policy, however, the Commissioner would hold such a recovery subject to tax as income to the extent that it represents gain to the taxpayer (such as lost profits), as distinguished from a recovery which merely makes the taxpayer whole.

4. *Proceeds of insurance for loss of occupancy.* In 1920 the Commissioner ruled that recovery under a use and occupancy policy of insurance of a sum of money as compensation for the loss of use of a factory constituted taxable income. 3 Cum. Bull. 89 (1920). This rule is now incorporated in Treasury Regulations 118, Section 39.112 (f)–1 (c) (8), which provides:

> The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

II

CONGRESSIONAL MATERIALS

In connection with its consideration of the bill which became the 1954 Code, the House Ways and Means Committee considered the question whether payments of punitive damages should be specifically excluded from tax as income. The Chairman of the Committee, under date of March 3, 1955, has informed the Commissioner of Internal Revenue as follows:

> On January 20, 1954, the Committee, while considering Confidential Committee Print No. 1 dated January 7, 1954, reached section 68 of Confidential Committee Print

No. 1. In this Committee Print, section 68 was under Part III—Items Specifically Excluded from Gross Income. Section 68 in the Confidential Committee Print read as follows:

Sec. 68. Punitive Damages.

Gross income does not include amounts received as punitive damages.

The Chief of Staff of the Joint Committee on Internal Revenue Taxation, Mr. Colin F. Stam, presented an explanation of this section as follows:

Sec. 68. Punitive Damages.

This is a new section designed to codify the decision of the Tax Court in *Goldman Theatres, Inc.* (1953) 19 T. C. 637. This case held that two-thirds of a treble damage judgment under the Federal antitrust laws represents punitive damages not included in gross income under the 1939 Internal Revenue Code. The exclusion, of course, does not apply to such portion of a damage judgment as represents compensation for loss of earnings.

After this explanation was presented to the Committee, and after some discussion by the Committee, the Committee voted on a roll call vote, a majority of the Members being present, to delete section 68 from the Confidential Committee Print.

III

CONCLUSION

The Commissioner has consistently maintained the position that punitive damages arising from actions involving injury to business are taxable as income. More generally, the Commissioner has held that all receipts that constitute gain to the taxpayer constitute taxable income.

The House Ways and Means Committee, moreover, when it recently considered the taxability of punitive damages, *declined* to include in the Code a provision which would have excluded payments of punitive damages from tax.

This is not, therefore, a case like *Helvering* v. *Griffiths,* 318 U. S. 371, where the administrative and legislative history of the matter in issue was overwhelmingly contrary to the position asserted by the Commissioner. By contrast, the Commissioner's position in the instant cases is consistent with that he has maintained over the years, that is, that punitive damages are taxable as income under Section 22 (a).

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.

MARCH 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955